



*Rosalind M. Hewsenian*  
*Managing Director*  
September 1, 2005

Mr. Mark Anson  
Chief Investment Officer  
California Public Employees' Retirement System  
400 P Street, Suite 3492  
Sacramento, CA 95814

Re: Domestic Equity Contract Renewal Recommendation<sup>1</sup>

Dear Mark,

You requested Wilshire's opinion with respect to Staff's recommendation pertaining to the annual review and renewal of the contracts of the domestic equity managers. Wilshire concurs with Staff's recommendations, though we are closely watching three managers.

#### **Discussion**

During fiscal year 2004/2005, Staff made improvements to the active domestic equity manager program by introducing enhanced indexation. Near the end of 2004, Staff created a spring-fed pool of external enhanced index managers and funded six managers in 2004 and one in 2005. The external enhanced index managers as a group have added value by producing consistent active return while keeping an appropriate risk profile.

In addition, several under-performing managers have resigned their accounts. The current stable of six active external managers has mainly outperformed their respective benchmarks since inception, though we are closely watching three managers. Therefore, we support the annual contract renewal recommendation.

The three managers we are closely watching are AllianceBernstein, Franklin Advisors, and JP Morgan. While we believe that no action should be taken at this time, we will be closely monitoring these managers in the near future. Below are discussions on each of the three managers.

#### **AllianceBernstein**

AllianceBernstein utilizes a bottom-up approach for their security selection that emphasizes the present value of each company's future cash flow. Using the cash flow

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<sup>1</sup> Wilshire's Code of Conduct requires us to disclose which of the above firms are clients of Wilshire's Analytics Services Division and as such pay Wilshire a fee for the licensing of analytical software used in investment management. Wilshire's consulting division has no business relationship with them. This disclosure has been delivered under separate cover.

analysis conducted by their analysts to calculate the present value of a company's future cash flows, AllianceBernstein compares the present value to the current price of the stock to find those companies that have the highest expected return. Unfortunately, their strategy has been negatively affected by the narrow range in valuations resulting in poor stock selection in sectors such as consumer discretionary and materials. Although, the portfolio has underperformed three out of the four fiscal years since the account inception date, the strategy has outperformed by 365 basis points since the account inception date. Wilshire will work with Staff to closely monitor this manager over the next few periods.

### **Franklin Advisors**

Franklin Advisors is an active domestic equity growth manager that builds its portfolio based on fundamental research and insight on investment themes and sector outlook. The companies in which Franklin invests tend to have strong growth potential, persuasive valuations, strong financial health and sustainable competitive advantages. As a result of the rally in more value-oriented sectors, such as Energy and Materials, the portfolio's growth bias caused it to underperform during the fiscal years 2003/2004 and 2004/2005. For the fiscal year 2003/2004, the portfolio underperformed its benchmark by 61 basis points relative to its custom benchmark. For the fiscal year 2004/2005, the underperformance increased to 416 basis points. Since the inception of the account the manager has underperformed by 125 basis points. Wilshire continues to have confidence in this manager but will continue to monitor the situation.


### **JP Morgan**

JP Morgan actively manages this account using a structured, risk-controlled process. Utilizing fundamental research and strict risk controls, JP Morgan seeks to build a low-turnover portfolio with 5 yr earnings per share, 5 yr dividend yields, Price/Earnings and Price/Book ratios marginally higher than the custom benchmark. Risk is controlled by limiting active weights to 1%, which contributed to a Beta of 0.93. JP Morgan has outperformed its benchmark in each of the past two fiscal years but has lagged by 73 basis points since inception. Wilshire continues to endorse JP Morgan due to its disciplined risk controls and high commitment to investment research but will monitor this situation closely.

### **Conclusion**

While Wilshire is closely watching the above mentioned managers, Wilshire concurs with Staff's recommendation to renew the contracts for all of the external active domestic equity managers and the external enhanced index domestic equity managers. Wilshire will continue to monitor these managers over the coming months.

Sincerely,

Handwritten signature of R. M. Huseinian in cursive script.